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UK-ARGENTINA: Argentines Await Assault

(Information as of 2300 EDT)

//Little military activity was reported yesterday, and both sides apparently continued preparations for an imminent military showdown. The mood in both capitals was somber as it became apparent that eleventh-hour UN diplomatic efforts were not yielding any positive results. The Argentine military leadership reportedly remains unwavering, believing that military defeat is more honorable than an unsatisfactory negotiated settlement.//

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//British Sea Harrier aircraft attacked the airfield at Port Stanley yesterday, according to Argentina's military command. No results were reported. The 20 Harrier aircraft brought to the Falklands area on a container ship reportedly have been transferred to the British aircraft carriers.//

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Comment: //The British are attempting to locate Argentine troop concentrations and to soften up the garrison on the Falklands prior to an attack. Thus far, recent bombings and shellings appear to have caused only minimal damage. The Harriers that have been transferred to the carriers are now available to provide air cover and close air support for assault forces. The British probably had to transfer the helicopters that have been on the carriers to other ships to make space for the new aircraft, which join 17 Sea Harriers already operating with the fleet.//

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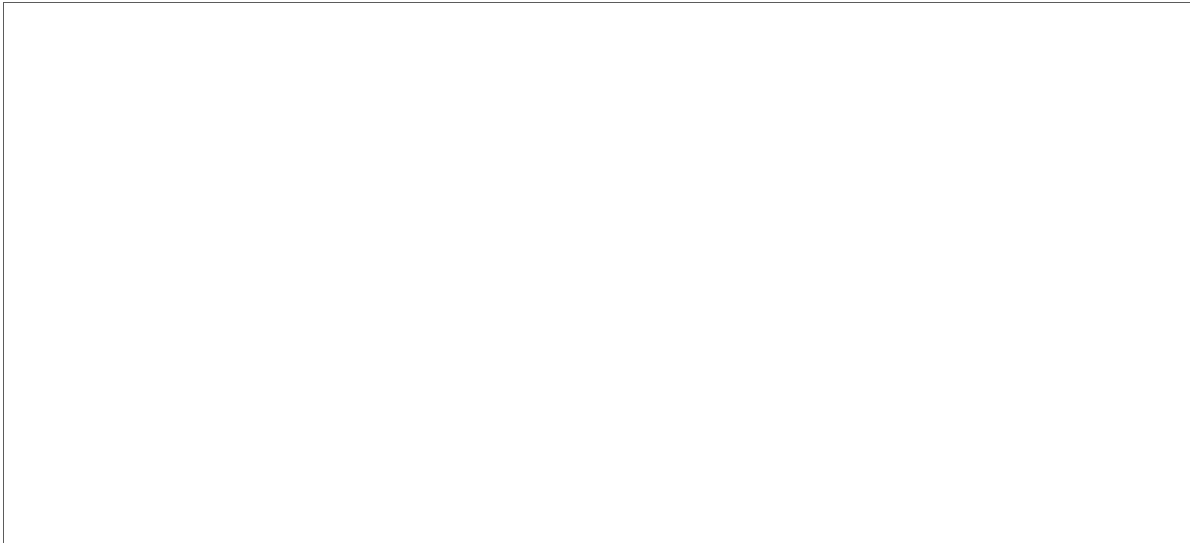
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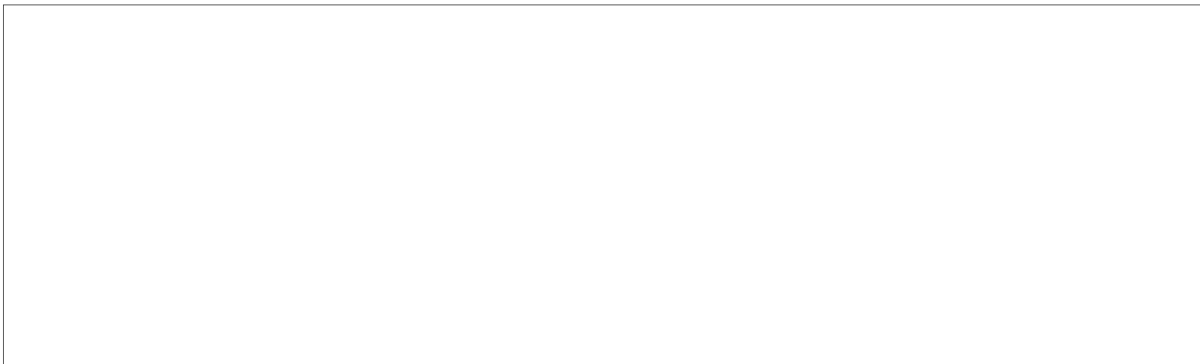
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Argentine Military Leadership Unwavering



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[REDACTED] Buenos Aires's belief that over the long term London will be unable to sustain either its military or its diplomatic position has made Argentina less flexible in negotiations.// [REDACTED]

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Weather Deteriorating

//Weather satellites indicate that seas will be heavy around the Falklands through most of today, with waves building to about 20 feet, but that the weather probably will improve on Friday.// [REDACTED]

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Comment: //The bad weather will hinder any assault operations through tomorrow. The high waves will prevent the use of most landing craft, and high winds will make

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flyng helicopters hazardous. If the British can operate under these conditions, however, they will be less vulnerable to Argentine air power based on the mainland.//

Mood in the UK

//Parliament will again consider the Falkland dispute today, but the mood in the UK is somber. An attack on the Falklands is generally expected in the next few days.//

Comment: //The parliamentary consensus supporting the government's handling of the crisis may be weakening as the prospect of a settlement recedes. The debate today will give the government a last chance to convince opposition moderates that all reasonable attempts to achieve a peaceful settlement have been made. Thatcher will not be willing to make any concessions, however, either by including the opposition in government councils or by engaging in obviously futile negotiations with the Argentines.//

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ISRAEL: Political Prospects

Prime Minister Begin will now seek to add new members to his coalition while trying to convince his governing partners that they should support new elections at an early date. [REDACTED]

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Begin survived the no-confidence vote yesterday because the abstentions of the two-man TELEM faction and one member of the far-right Tehiya Party prevented the opposition from obtaining a plurality. Labor worked hard to persuade TELEM to vote against the government but reportedly balked at the party's demand that Labor pledge to impose autonomy in the West Bank and Gaza unilaterally if it came to power. [REDACTED]

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Comment: The abstention of one of Tehiya's three members in the Knesset may encourage Begin to reopen negotiations with that party in his effort to rebuild a majority. Even if he attracts additional support, however, he almost certainly also will redouble his efforts to schedule new elections. He probably believes the challenge yesterday has weakened his mandate to move forcefully on key foreign and domestic policy issues. [REDACTED]

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The coalition's precarious position is likely to have little impact on Begin's policy on Lebanon, but his need for new coalition partners may force an even tougher line on the West Bank. Tehiya would at a minimum demand major new settlement activity in return for its support. According to press reports, the party leadership has hinted that it also might ask Begin to annex the area as the price of its joining the coalition. [REDACTED]

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UK-EC: Possible British Boycott

//The British Government may withdraw temporarily from EC decisionmaking and withhold its contribution to the EC budget, thereby causing the Community's worst crisis in 17 years.//

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//London's actions would be in retaliation for the decision of its partners on Tuesday to override its veto of EC farm price increases. The UK had been using the price issue as leverage to obtain a large rebate of its EC payments.//

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//London has accused EC members of violating the principle of unanimity on issues of vital national interest. The members claim that the UK acted improperly by obstructing Community operations to achieve its own ends.//

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Comment: //The patience of EC members apparently evaporated after their efforts to preserve a united front on renewal of the sanctions against Argentina and to settle the rebate dispute failed to inspire a British compromise. They appear resigned to a temporary British boycott of the Community.//

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//Although routine EC activities should not be substantially affected in the short term, the political consequences could be severe. Most EC members will not want to make decisions on key issues without the UK. More important, British retaliation against the EC would destroy the veneer of Community solidarity at a time when members have been promoting economic and political cooperation.//

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//Prime Minister Thatcher may be in no hurry to reconcile with her partners. The EC is unpopular in the UK, and its unenthusiastic one-week extension of the sanctions and approval of farm price increases over the UK's objections have further alienated the British public. Thatcher will want to take a tough stance toward the EC, especially if she decides to call for early national elections to capitalize on her current popularity.//

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USSR-FINLAND: Soviets Reprimand Finnish Party

A Soviet memorandum delivered to senior party leaders just before the Finnish Communist Party's extraordinary congress last weekend contributed to the breakdown of the attempt to reunite the divided party.

The Soviets noted the questioning by some Finnish Communists of the sincerity of Moscow's "peace" policies and their calls for an independent peace movement directed against both superpowers. They condemned the advocacy by some Finnish party liberals of a "historic compromise" to establish a new basis for cooperation with Social Democrats and nonsocialist liberals.

Outgoing party Chairman Saarinen rejected the assessment, replying that the party would not tolerate Soviet interference in its internal affairs. Party hardliners, who had relied heavily on Soviet support to strengthen their position, lost much of their representation in the party leadership.

Arvo Aalto, the favorite to succeed Saarinen and a leading proponent of the "historic compromise," withdrew from consideration for the chairmanship. Nonetheless, the Stalinists were angered by the ouster of their leader from the party vice-chairmanship and refused to take their seats on the new Central Committee.

Comment: The reprimand reflects Soviet fears of losing an instrument of influence while Moscow still is not comfortable with independent-minded President Koivisto. Soviet influence in the Finnish party probably will be reduced as a result of the memorandum's criticism of the "historic compromise" after a period of encouraging Finnish Communists to broaden their ties with other political parties.

The deadlock between the two factions at the congress probably has moved the Finnish Party still closer to a permanent schism. The disarray among the Communists will spur non-Communist members of the party's electoral front to increase their efforts to develop their own organizational network.

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MADAGASCAR: Risky Austerity Program

President Ratsiraka imposed a series of tough economic measures this week, including a doubling of the price of rice, a 15-percent devaluation, and curbs on government spending. The moves, which were urged by the IMF, clear the way for a \$50 million standby loan.

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Comment: Rising food prices could provoke widespread urban unrest. The military may balk at maintaining security for Ratsiraka's already shaky regime if the volatile Malagasy take to the streets, as they have done on several occasions during the past year. Despite Ratsiraka's pro-Soviet rhetoric and reliance on the USSR for military aid, the failure of his socialist policies leaves him little alternative but to turn to the West for economic help.

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SPECIAL ANALYSIS

MEXICO: Looming Economic Crisis

//Mexico's economic and financial trouble could disrupt political and social stability there, if it is not resolved soon. President Lopez Portillo, however, will go to great lengths to avoid taking the necessary harsh measures before the elections on 4 July. Meanwhile, Mexico has run out of money and will owe \$10 billion in debt service obligations during the rest of 1982. This will result in fewer US exports to Mexico, increased illegal migration and narcotics shipments, and possible large losses for US banks.//

//After the oil boom that lasted from 1977 to 1981, Mexico has had to cope with galloping inflation and a total external debt of \$67.5 billion as of the end of last year. Lopez Portillo nevertheless wants to end his term without slowing the economy and submitted a budget for 1982 that continued the rapid expansion in spending and projected a \$40 billion public-sector deficit.//

//In late 1981, foreign lender resistance mounted because bankers were concerned about the soft world oil market, the huge jump in debt service costs, and Mexico's soaring budget deficits and inflation. By early this year Mexicans also had lost confidence and began converting quantities of pesos into dollars. The resulting massive capital flight forced the Bank of Mexico to float the peso and draw its \$200 million reserve tranche from the International Monetary Fund. By March the peso had been devalued 40 percent.//

//Since March, however, government actions have undercut the possible beneficial effects of the devaluation. Rather than prune government spending and check expansion of the money supply, Lopez Portillo granted large wage hikes, increased government subsidies, and placed a 90-day price freeze on selected consumer goods.//

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The Drift in Policy

//As the economy has continued to deteriorate, Mexico City has promised to adopt more disciplined economic policies. Economic activity, however, is continuing to expand because of high government and consumer spending. The higher cost of imported goods probably has reduced new orders, but past orders are keeping imports up, and the wage settlements are encouraging more travel by Mexicans and more purchases at the border.//

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//Despite the stabilization policies announced a month ago and reaffirmed on Tuesday by Mexico's Finance Minister, action by the government has been disappointing. Doubts about its determination and ability to tighten monetary policies and cut government spending--the key to an austerity program--have caused another round of capital flight. Thus far, funding for only a small number of construction projects has been cut.//

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//The government has postponed action largely because it fears that hitting the consumer with higher prices, labor with fewer jobs, and business with reduced public-sector orders and projects would make the ruling Institutional Revolutionary Party the target of public criticism. In the midst of an election campaign, the government especially wants to avoid antagonizing organized labor, which traditionally plays a major role in mobilizing support for party candidates.//

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//The limited public enthusiasm for ruling party presidential candidate de la Madrid and the growing complaints about the economic situation have given party leaders cause for worry. Although de la Madrid is certain to win, party leaders--mindful of the difficulty he has had in establishing rapport with labor--fear that more austerity measures would result in high voter absenteeism and a substantial protest vote for opposition parties. This would embarrass the government and complicate the task of the incoming administration in grappling with economic difficulties and other issues.//

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Lack of Liquid Funds

//With its foreign exchange reserves virtually exhausted and private loans increasingly expensive and difficult to obtain, Mexico City is critically short of foreign exchange. This crisis occurs with seven months left in Lopez Portillo's lameduck administration and with \$10 billion of debt service still to be paid this year. Mexico is negotiating a new \$2.5 billion loan, but it will be several weeks before even half these funds become available. To come up with fresh funds, Mexico City is casting about for possible new oil sales or other loans.// [redacted]

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//The Bank of Mexico may soon be forced to withdraw from the foreign exchange market and once again devalue the peso. Under current market conditions, the peso would drop sharply.// [redacted]

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//An alternate step would be to freeze private dollar deposits in Mexican banks--now totaling some \$12 billion--and impose import and exchange controls. While freezing dollar accounts would be easy, exchange controls would be difficult to enforce and might not slow capital flight. Both of these steps, moreover, would make it harder for Mexico to attract new foreign capital.// [redacted]

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Outlook Through 1982

//Mexico's economic difficulties are going to get worse before they have any chance of getting better. Its worsening international credit rating will force a cut-back in imports, while economic growth will slow. Until a serious austerity program is well established--one that could earn IMF support--Mexico City will be unable to slow the flight of capital, the depreciation of its currency, or the acceleration of inflation.// [redacted]

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//The longer austerity is postponed, the greater the likelihood that the Mexicans will have to seek formal IMF backing, large emergency loans from the US, and a major rescheduling of its debts involving postponed payments of as much as \$18 billion it owes in interest obligations during the rest of 1982 and 1983.// [redacted]

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Implications for the US

//US interests will be affected no matter what Mexico does. The longer Mexico City procrastinates, the more severe the impact will be.//

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//Even if austerity measures are taken US exports to Mexico would decline markedly from the \$18 billion level last year. In addition, some of the \$7 billion invested by US business in Mexican industry almost certainly would be affected, and slower economic growth would lead to more illegal migration and would encourage narcotics shipments. Without a stabilization program, the impact would be more severe and extensive.//

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